

The City of Lynchburg

Review of Payroll – Other Pay/Overtime

February 27, 2006



Prepared by the Department of Internal Audit

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Background

The City's payroll is processed on the New World Systems payroll module on a bi-weekly basis. Data to create/change employee master files is entered to the system by staff in Human Resources. Departmental payroll clerks enter hours, other pay and leave information. Once the clerk has entered the payroll information, the approval manager is responsible for reviewing the data for accuracy. There is an approval screen on the system which the manager accesses to approve the payroll and release it to Financial Services for completion of the payment process.

Employees' scheduled hours and ongoing "other pay" amounts are programmed in the system and are automatically accessed when the "create hours option" is selected. Payroll clerks then adjust the scheduled hours for leave, overtime, etc. by entering "hours codes". The system computes overtime for non-exempt employees using the scheduled hourly rates when the appropriate overtime code is entered. The system, however, does not allow overtime hours to be entered for exempt employees. Therefore, any payments to these employees for time in addition to scheduled hours are calculated by payroll clerks and entered in the "other pay" field using the OH35 (full-time employees), OH36 (Part-time employees) or OH37 (wage employees) codes.

In addition to overtime, the "other pay" field is used for various allowances and supplemental benefits, including the employer match for deferred compensation, certification pay, technical team payments and progression pay.

This review was performed at the request of the Deputy City Manager.

Scope of Work

The review covered the period of January 1, 2005 through August 31, 2005 and included a review of various "Other Pay" and "overtime" categories paid within that timeframe. Support documentation for each selected payment was reviewed to ensure proper approvals were obtained and amounts were recalculated and traced to the system data to ensure proper coding. During the process, we also performed interviews with the relevant departmental personnel involved in preparing and approving payroll.

The audit was conducted in accordance with professional internal auditing and generally accepted governmental auditing standards specified in the City's Internal Audit Charter and, accordingly, included such tests of records and other audit procedures as were considered necessary in the circumstances.

The Internal Audit Department is free from organizational impairments to independence in our reporting as defined by government auditing standards. We report directly to an audit committee and, administratively to the city manager and are organizationally outside the staff or line management function of the areas we audit.

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Opinion On Internal Controls

The objectives of a system of internal control are to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and are properly recorded.

It is our opinion that the inconsistencies in documentation, data entry, approval methods and the maintenance of payroll files within the City allow inappropriate and unauthorized transactions to occur.

Sampling Methodology

Our review included testing transactions for the various "other pay" and "overtime" codes. We combined the codes OH35 (Other Pay For Full-Time Employees), OH36 (Other Pay For Part-Time Employees) and OH37 (Other Pay For Wage Employees) for testing. There were 515 transactions, totaling \$170,526.00, for these codes during the period of review. Our sample included 261 transactions representing 73% (\$123,830.00) of the total payout.

A separate test was performed for the Fire Department's "other pay" codes for Progression Pay, Technical Team and Certification payments. Seventy-five (75) of the 131 transactions for the period were reviewed. The sample value of \$100,198.00 represented 81% of the total payment amount of \$123,293.00.

Payroll codes for "Overtime @Straight time rate", "Public Services overtime @ straight time rate", "Overtime Other Pay" and "Overtime @time and a half" were also combined for testing. This category included 11,368 transactions totaling \$834,432.00. Due to the volume of instances, we selected the departments in which the most overtime was paid and scanned for unusual occurrences. This sample included payments totaling \$448,327.00, representing 54% of the total overtime expenditures. From this sample, a sub-selection of 231 instances was made for transaction testing.

On-call overtime codes used within the Protective Services unit in the Department of Social Services were also tested separately. Thirty-six payments totaling \$7,560.00 were made during the period of review. All of these transactions were included in the testing.

Observations and Suggestions

I .Weak Controls Over Review and Approval of Payroll Data

The following errors and control issues were noted during our testing of data entries and review of departmental payroll documentation:

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- a. An instance was found where double entries of other pay were paid to several employees in the City Manager's Office. This was caused when the payroll clerk created "Scheduled Hours" twice. The overpayments were not caught by the clerk or the Payroll Approval Manager. The error was corrected when brought to their attention.
- b. In Communications and Marketing, the payroll clerk failed to select the "create scheduled hours" option for three payroll periods. She manually entered the regular time and leave for each employee, but failed to enter the employer's contributions to deferred compensation. The errors were not caught by the clerk or the Payroll Approval Manager, but were corrected when brought to their attention.
- c. We found no written support or approval documented for the payment of bonuses to two employees in Financial Services for approximately \$4,800.00 each. We were told that verbal approval had been given by the department director.
- d. Another Financial Services employee performed work for another department in which she previously worked. The hours worked were approved by a supervisor within that department. For one week, the employee had added the documented hours incorrectly and was paid for one hour more than she worked. It appears that the payroll clerk did not ensure the accuracy of the amount prior to entry.
- e. In several departments, we noted inconsistency in the use of the payroll codes OH35 (Other pay for full-time employees) and OH37 (Other pay for wage employees). These two codes were used interchangeably for the same employees. We also noted some cases in which overtime was paid using the OH35 (other pay) code instead of the appropriate overtime code.
- f. For two employees whose time was split between two work areas, the general ledger distribution for payment of work in the secondary work area was charged to the primary general ledger distribution account in error.
- g. We found two instances in which a wage employee worked in two departments at different hourly rates of pay and was paid the wrong rate of pay in each department.

Suggestion

Based on the numerous transactions reviewed, we believe the number of errors to be insignificant; however, controls over the process are weakened due to the lack of proper reviews and approvals in some departments.

We suggest that payroll clerks and approval managers receive adequate training to ensure the accuracy of data entry and the adequacy of manager-level reviews. More accountability for the accuracy of the payroll information should be placed with the payroll managers.

Management Response:

Concur: Authorization of transactions, particularly those involving payroll, dictate a high degree of accountability. Most City employees with payroll

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responsibilities (payroll clerks, as well as payroll approval managers and central personnel in Financial Services and Human Resources) approach their review and approval responsibilities in a professional manner and adequately question and document all aspects of payroll, including other pay. The City Manager, at a recent Key Leaders Forum reminded all employees in attendance of the level of care they should bring to any transaction they authorize and that there would be consequences for those who approach their responsibilities lightly. The City Manager's office has asked Financial Services and Human Resources to help identify those individuals who are not using the degree of care in authorizing transactions, as errors occur, so that the individuals responsible could be held accountable.

II. Weak System Controls

During the course of this review, we performed several tests of the New World Payroll system in an attempt to determine control weaknesses and potential causes of errors and overpayments. These tests were performed using the standard system access given to each City Payroll Clerk.

In this test, we were able to perform the following inappropriate transactions:

1. We increased the quantity of "regular" hours to be paid during the tested payroll cycle. The system accepted an entry exceeding 80 regular hours in the payroll cycle and printed the error on the "Hours Error Exception Report".

We discussed this with the System's Analyst in the Information Technology department and were told the regular hours cannot be limited to an 80-hour schedule in the system due to the difference in work schedules in some departments.

2. We entered inappropriate payments in various Other Pay categories. This did not show on the exception report, but appeared on the "Detail Hours Register".
3. We also created scheduled hours twice, thereby doubling the other pay amounts, and we bypassed the "Create Scheduled Hours" option, both of which we noted as causes of errors in our test sample reported earlier in this report.

We noted that the "Detail Hours Register" will always print the programmed scheduled hours when a "yes" is selected for the accrual type field. If the "no" option is selected, the report will show any manual changes and/or additions. It is our understanding that both options of this register should be printed for each payroll cycle. Therefore, if the approval manager reviews the reports, errors should be caught.

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Suggestion

We suggest, as above, that greater emphasis be placed on payroll approvals by ensuring that the “Hours Error Exception Report” and both “Detail Hours Registers” are reviewed for accuracy and initialed by the approval managers. We also suggest that management consider making a modification to the system to disallow entering “create scheduled hours” more than once for a specific payroll batch. This would eliminate multiple payments of scheduled “other pay” amounts.

Management Response

Concur: The published procedures for review and approval of payroll dictate that the three standard payroll reports are printed and reviewed and initialed by both payroll clerk and approval manager before entering their approval into the payroll system. In addition, if exceptions are noted on the Hours Error Exception Report, payroll clerks must send an email to central payroll processing to justify the discrepancy.

The first management response above details plans to ensure greater accountability in the review and approval process.

Action Plan regarding system modification suggested: Information Technology must approve all modifications to the standard program. Financial Services will request a quote from New World Systems for both the initial programming and ongoing maintenance of the suggested program change. Pending management authorization and budget considerations, the modification will be initiated and implemented.

III. Untimely, Outdated Information

During our review, we met with many Payroll Clerks who told us they were sometimes unsure of how to handle specific situations within their departments. Some expressed frustration about the lack of responses to their questions, or not receiving the responses in a timely manner. In these situations, they would make decisions on their own. Sometimes these decisions created other problems, which then had to be resolved.

The “Departmental Hours Entry” manual issued to Payroll Clerks at the onset of the New World Systems implementation has not been updated. Instead, as changes occur, individual e-mails or memorandums are issued to the clerks. This method makes it difficult to identify the correct process at any given time due to an abundance of loose papers.

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Suggestion

We suggest that the payroll manual be revised to include **all** information necessary to process payroll. We also suggest that the manual include requirements for documentation and the review and approval process. Due to the sensitive nature of payroll and the ease of making erroneous or potentially fraudulent entries, we again suggest the importance of training for new payroll clerks and approval managers.

Management Response

Concur: All payroll procedural information is currently not housed in a single document, however, as Financial Services is made aware of new payroll clerks/approval managers the entire payroll training set of documents is emailed and training is scheduled. The clerks are instructed to print out all the documents and bring them to the training. The training emphasizes the high degree of accountability inherent in approving payroll transactions. In addition to the initial training, each time the payroll groups are gathered (on average 2 to 3 times per year), the Accounting Operations Administrator stresses to those in attendance the high degree of accountability inherent in reviewing and approving payroll transactions.

Action Plan: Pending the availability of the Information Technology training room, monthly payroll clerk and approval manager training will be scheduled. Also, Financial Services will request a new procedure for Information Technology to notify Financial Services whenever a City employee is given payroll security authorization (so that we can insure that the employee signed up for and received training). Currently, central payroll processing does not get this information and must rely on a request for training from the user department or word of mouth when payroll responsibilities change.

Also, the current payroll processing manual will be revised to include all the subsequent chapters. The manual will be posted on the City's Intranet site so that it is available to all users, at all times. Estimated completion for posting of revised documentation to the City's Intranet is June 30, 2006.

Other Comments

We appreciate the cooperation and assistance we received from city-wide employees while conducting this review. We are available to discuss this report should there be any questions or concerns.

Carol Bibb
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